

Gearing up for self-rule in East Timor

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After the vote for independence on 30 August 1999, East Timor acquired the status of the world's newest nation. The country is currently administered by the United Nations Transitional Administration for East Timor (UNTAET), the term for which will expire after elections bring in a new government with self-rule in 2002.

UNTAET has a large presence in the country. The number of uniformed personnel as of 1 January 2001 was 9,287 comprising some 7,765 military, 1,398 civilian police, and 124 military observers. Another 888 international civilian personnel and 1,767 local civilian staff support these uniformed officers. These operations are financed via a special account with an appropriation of US\$563 million for the 2000/2001 financial year.¹ The presence of such a large contingent of administrators and disciplinary forces, drawn from a very wide cross-section of the global community, was seen as necessary to provide stability and credence to the new nation. The handing over of the reins to local authorities after new elections and the subsequent departure of the foreign personnel and resources as part of the graduation process to self-rule will pose several challenges for the incoming administration. Filling top administrative positions with people possessing the necessary skills will be of major concern.

East Timor became a Portuguese colony in the 16th century while the rest of the region that now is Indonesia was controlled by the The Netherlands and was then known as the Dutch East Indies. While the Dutch departed in the 1950s with the emergence of the Republic of Indonesia, East Timor remained under Portuguese control until 1975 when Indonesia annexed the state. The independence movement began then, culminating in 25 years of struggle with reports of significant loss to life and property. President B.J. Habibie of the Republic of Indonesia announced his willingness to hold a referendum on East Timorese independence in February 1999. On 30 August 1999, some 78 per cent of the East Timorese voted for independence in the UN-organised referendum.

Several challenges remain to be overcome, but perhaps the largest of these for the East Timorese is to draw a curtain on the terrible legacies of history and particularly the dreadful outcomes of the civil conflicts of the recent past. In doing so, lessons from history have to be used to contemplate the enormous development challenges of the immediate future given the poor state of human development. Much of the physical infrastructure is in desperate need of repair and rebuilding after years of neglect and damage from the recent conflict,

and much of the financial, human and entrepreneurial capital fled the country during the period of intense conflict. With a history of neglect and oppression, many of these challenges may appear insuperable (Hill 2001).

The tyranny of (small) numbers

The starting point for development in terms of per capita income and the various social indicators presents a grim picture for East Timor. Per capita income per annum is estimated to be US\$300, life expectancy at birth is estimated at 62 years, and some 25 per cent of the adult population are reported to be illiterate (Hill 2001). East Timor, with a population of 840,000, a land area of 14.6 square kilometres, and aggregate GDP of US\$252 million, is by all measures a small economy.

Even with very favourable growth of the economy, it would be a considerable time before per capita incomes catch up with those of neighbouring Indonesia and Malaysia. For example, it would take 19 years at growth rates of per capita income of 7 per cent to reach the current level of per capita income of US\$1,110 in neighbouring Indonesia.

The high population growth rate of 2 per cent implies a large and growing population of individuals in search of employment. At present, more than half the population does not have regular employment (Hill 2001). Unless investment picks up, creating employment opportunities for the growing pool of young unskilled workers, social problems including crime could become a serious threat (as in Papua New Guinea). Many of the youth and unemployed have either witnessed or taken an active part in the independence struggle and hence have the potential to have a destabilising effect should they not see material improvements in their well being in the near future. The departure of UN forces will put added strain

on local forces to maintain law and order. This makes economic progress all the more urgent.

Low literacy rates point to a small pool of potential leaders and administrators.² The number of tertiary qualified people in East Timor can be estimated at a maximum of 15,000, providing members of parliament including cabinet ministers, ambassadors, the members of the bench, the media, the accountants and auditors, the engineers and technicians, the business people, doctors, teachers, and so on; all of whom are necessary for a modern state. Fiji, a country of comparable population, has approximately 40,000 public servants and East Timor during Indonesian rule had approximately 33,000 public servants. These figures are suggestive of the gap between the supply of and demand for talent, an issue that will have to be addressed immediately by the incoming administration.

The simple fact is that there are not sufficient numbers of qualified people to fill all the positions that come with the formation of a modern state. Harberger (1988), writing in the context of small (defined as having a population less than 10 million) developing countries, notes that 'the implications of this demographic fact are both sobering and enlightening' (Harberger 1988:250).

The incoming administration would need to import skills, but this would be at the international prices for these skills. The prevailing budgetary situation implies that there would be little room for manoeuvre on this front.

The pool of potential leaders comprising people aged 40 years and above is also small. Amongst this cohort, the tertiary-educated élite makes up a few hundred individuals only. Many of these individuals will be required to shoulder heavy responsibilities as members of the legislature, judiciary, or the executive. Many of these individuals have strong kinship ties as friends, former freedom fighters, and/or alumni of the same

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schools. These facts make it difficult for the process of governance to remain impersonal, impartial, and just. In many cases, the checks and balances in the system of government would be strained due to personal and kinship ties as a result of what Harberger (1988) calls the 'curse of demography'.

Some policy responses

Faced with a dearth of trained talent, the public sector should organise itself so as to make frugal use of this scarce resource. The system of government has to be designed with the view that under-qualified and under-experienced personnel may have to administer it. The reality is that many of the rules and regulations would be implemented or enforced by ground troops with very basic training. For example, officers with secondary education may do much of the enforcement of regulations. Designing rules that explicitly build in such capacity constraints is likely to deliver better governance. It has to be noted that regulations are only as good as their enforcement; paper constructs that fail to materialise erode the credibility of the institutions of civil society.

The design of regulatory systems should aim at setting simple rules that can be enforced, given the capacity constraints. For example, the tax and tariff systems need to be kept simple and formula-based so regulators are not given discretionary powers. Doing so reduces the need for superior enforcement capacity and minimises opportunities for corruption. In a system where remedial actions require detection and enforcement capacity that are at a premium, the systems need to be designed so as to minimise the need for such capacity. Experiences from several Pacific island countries show that regulations are only as good as their enforcement and the *wantok* system makes the task of impersonal, impartial, and even-handed governance an extremely difficult one. For example, the

inability to enforce banking regulations in Fiji and Papua New Guinea and not the lack of such regulations were the reason for recent problems in their state-run banks (Chand 2001).

The US dollar is currently used as East Timor's domestic currency. Two foreign banks operate in the capital, Dili. The use of a foreign currency implies that policymakers no longer have access to monetary policy for stabilisation, but in the current context of limited capacity to exercise this option it is suggested that this is a beneficial trade-off. Fiscal policy, particularly budgetary discipline, together with flexible prices including interest rate flexibility, will be central to the stabilisation process. An external shock or a shift in monetary policy in the United States that is not conducive to the economic conditions prevailing in East Timor would necessitate movements in domestic prices. Having this price flexibility, particularly downward wage flexibility, reduces the need for active use of stabilisation policy.

Enforcement of complex tax and tariff systems in various developing countries has provided opportunities for corruption. The lesson here is to make taxes transparent and easy to collect with a minimal number of graduations in the tax scale so as to minimise opportunities for tax arbitrage. A single-rate, value-added tax, say of 10 per cent, together with a single personal and company income tax rate with an income tax-free threshold for individuals is an option worthy of some consideration. The government needs to consider outsourcing some of the compliance enforcement activities to reputable agencies. For example, resource companies could be audited by the Large Business Office (LBO) of the UK Inland Revenue or the Large and International Business-line of the Australian Taxation Office. Having such well-articulated mechanisms in place to enforce tax compliance will induce socially desirable behaviour by all economic agents.

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East Timor is in need of massive capital works, but the authorities have to ensure that they have the capacity to maintain any assets for their full life to reap maximum benefit from such investments. Experience in the Pacific islands shows that donors are often keen to fund massive capital infrastructure developments, but such investments have often failed to deliver their full value because of failure to maintain these assets. Road construction in Papua New Guinea is a good example where large aid-funded projects have become a serious drain on the budget due to the need for ongoing maintenance—or could be—if repairs and maintenance were actually carried out. Policymakers have to ensure that capital works funded from foreign sources do not outpace the local resource capacity to maintain these assets. Aid fatigue sets in quickly when donors realise that their capital works will either not be maintained or be used as a means to lock in long-term aid to the project.

The government should refrain from taking an active part in commerce, make their intent clear on providing impartial service to the community public, and encourage private audit of their activities. The small and enclave nature of the accounting, media, and legal professions requires foreign participation in these sectors. Within the short to medium term, the appeal courts should comprise a majority of foreign judges, the office of the auditor general and that of the police commissioner could also remain open to foreign nationals. Understanding could be reached with donor agencies to fund these offices during the transition. The longer-term solution would be to build professional competence and a system of peer review to ensure impartiality in the provision of judicial and auditing services to the public sector. Furthermore, legislation could be enacted to provide unfettered access to news in the country by foreign and local media in the interests of transparency.

Conclusions

East Timor moves to complete self-rule in 2002 and the incoming administration has several large challenges to face, not least of which is to overcome the memories of recent violence. The prevailing conditions in terms of low per capita income of US\$300 coupled with poor social indicators of development indicates the need for rapid economic progress. Even by emulating the growth rates of the fastest-growing economies of Southeast Asia, the low starting point implies that the East Timorese will take decades to catch up with the income levels in neighbouring Indonesia and Malaysia.

The small population size, together with the low levels of literacy and the large and growing numbers of individuals entering the workforce raises several challenges for the incoming administration. First, the tyranny of small populations and the enclave nature of various professions will make it difficult to run a completely impersonal, impartial and even-handed administration. This problem can be capped by minimising the extent of discretion given to regulators, enacting freedom of access to information to both local and foreign media, and fostering foreign participation in the executive and the judiciary. The longer-term strategy should be to build a professional public service that is open to peer review from both at home and abroad.

Low levels of literacy in a small population subject to a period of extreme instability have culminated in a very small pool of talent available to run a modern state. Systems, therefore, have to be designed so that they operate with minimal use of skilled and qualified personnel. Personnel with at most high-school education are likely to fill up to two-thirds of public service positions. Foreign workers with appropriate skills may be used for a few of the senior level positions, but budget constraints will not permit any significant expatriate presence in the local

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administration. Therefore, the regulatory systems will have to be designed to function with the minimal level of skill of the workforce. In particular, the taxation and tariff regimes need to be simple and rule based, allowing minimal opportunities for abuse and arbitrage.

Transparency is crucial for the modern state to operate in the interests of those that it governs. The judiciary and media will need foreign participation to provide professional and impartial service in the immediate to medium term. Donors should be asked to support such undertakings. Capacity building will be the longer-term solution.

There is a dearth of infrastructure and hence the likelihood of seeing large capital works funded under donor assistance. These assets require ongoing maintenance, an expense that donors are reluctant to absorb. The budgetary position will need to be strengthened so as to cope with such cost imposts from capital investments undertaken by donors. Some coordination between donors and the government is needed on this front. East Timor has already made it through a very difficult period. The above challenges, though difficult, are surmountable given the track record to date.

Notes

- ¹ These figures are drawn from <http://www.un.org/peace/etimor/UntaetF.htm>
- ² Using proportions for Indonesia, East Timor with a population of 840,000 would have 64 per cent (equal to 537,000 individuals) of its population between the ages of 15 and 64 years. Of these, a quarter is estimated to be illiterate, implying a pool of 135,000 unskilled workers. The pool of tertiary qualified workers may be inferred as follows. Seven per cent of Indonesians had tertiary education in 1997 (World Bank 1999: Table 3). This very optimistic figure for East Timor translates

into some 38,000 individuals with tertiary education. Given a per capita income of one third of Indonesia together with the exodus of qualified personnel during the war, a more realistic figure for the number of qualified people in East Timor would be a maximum of 15,000.

References

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